This thesis deals with performance and growth in the Swedish banking sector, in an era following important changes such as the globalisation of financial markets, the harmonisation of legislation (e.g. the EU banking directives) and the implementation of new technology, such as Internet banking and other electronic delivery channels. The thesis consists of an introductory chapter and three self-contained papers.

Paper 1: Market power and performance in Swedish Banking

This paper analyses the degree of competition in the Swedish banking market, over the period 1996-2002. A structural simultaneous-equation model, which includes a conduct parameter, is estimated. The results indicate that the average bank’s conduct was more competitive than Cournot behaviour, although not perfectly competitive. The average Lerner index obtained equals 22%. Furthermore, the results indicate that competition among commercial banks was significantly more intense than among savings banks, despite the former’s much larger size. This finding may suggest that commercial banks operate in a more contestable environment. Finally, the results show that banks operating more than one office experienced significantly better performance, in terms of higher price-cost margins, than one-office banks (unit banks).

Paper 2: Competition in Swedish Local Banking Markets

In contrast to urban and metropolitan bank customers, rural bank customers still rely on the physical network (branches) as the prime access channel. This means that high customer loyalty and entry barriers can be expected to prevail in rural banking. Against this background, the paper analyses the degree of competition in rural banking markets, using a variation of the Bresnahan and Reiss entry model. According to the results, entry thresholds increase more than proportionately with each additional entry, suggesting that profit margins shrink as a result of new entry. The resulting pro-competitive effect is most pronounced in markets with a relatively few number of competitors. Finally, the results suggest that a greater share of “multi-market banks” in a given market promotes local competition – a result which parallels a number of international studies.

Paper 3: A Dynamic Analysis of Firm Growth in Swedish Banking

This paper examines firm growth dynamics in the new banking environment, by testing the validity of Gibrat’s Law of Proportionate Effect on Swedish data. The point of departure in the paper is the expectation that large banks should be able to more fully exploit scale and scope economies associated with technological innovations such as internet banking, than smaller banks, and therefore grow faster. Using a panel of 79 Swedish banks over the period 1995-2002, I find no empirical evidence that large banks grew faster, nor any significant evidence that firm sizes were mean-reverting. Hence the Law was not rejected. However, growth was not entirely random, as banks with a more diversified revenue mix experienced significantly higher growth rates than their less diversified counterparts.

JEL Classification: C23; C30; G21; L11; L13.

Keywords: Swedish banking, degree of competition, Lerner indexes, entry barriers, contestability, commercial banks, savings banks, branch banks, unit banks, GMM estimation, dynamic panel data model, firm growth, Gibrat’s law of proportionate effect, technological change, local banking markets, entry thresholds, ordered probit model, Poisson model.

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